



The City of Seattle Washington Comprehensive Annual Financial Report

December 31, 2004



The City of Seattle **Washington**

Comprehensive Annual Financial Report

December 31, 2004



Department of Executive Administration

Introduction

Comprehensive Annual Financial Report

For Year Ended December 31, 2004

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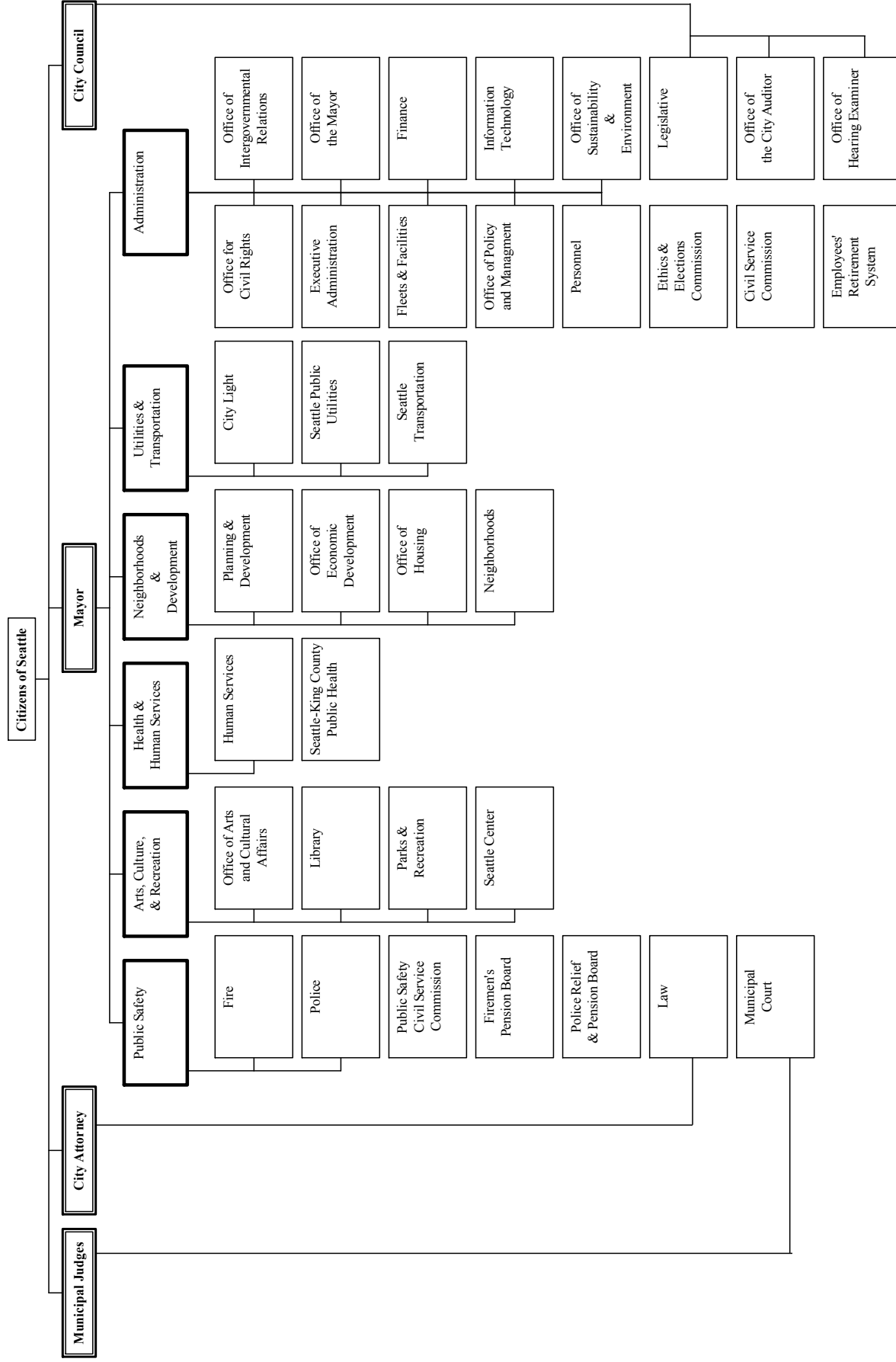
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CITY OF SEATTLE ELECTED OFFICIALS



Gregory J. Nickels
Mayor



Thomas A. Carr
City Attorney

CITY COUNCIL



Jim Compton



Richard Conlin



David Della



Jan Drago
Council President



Jean Godden



Nick Licata



Richard J. McIver



Tom Rasmussen

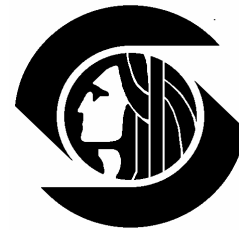


Peter Steinbrueck

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City of Seattle Department of Finance

Dwight Dively, Director
Gregory J. Nickels, Mayor



June 28, 2005

The Honorable Mayor and
Members of the City Council:

I am pleased to submit to you the 2004 Comprehensive Annual Financial Report (CAFR) of the City of Seattle, Washington. The Department of Executive Administration has prepared this report to present the financial position of the City of Seattle on December 31, 2004, and the results of its operations and the cash flows of its proprietary fund types and changes in plan net assets of its pension and private-purpose trust funds for the year then ended. The financial statements and supporting schedules have been prepared in accordance with generally accepted accounting principles and meet the requirements of the State Auditor and the City Charter.

Washington State law requires an annual audit of the City's financial statements by the independently elected State Auditor. The State Auditor conducts his examination in accordance with generally accepted auditing standards and provides an independent assessment that helps assure fair presentation of the City's financial position and results of operations and the cash flows of its proprietary fund types and changes in plan net assets of its pension and private-purpose trust funds. In addition to the opinion on the City's financial statements included in this report, the State Auditor also issues separate reports on internal control and compliance with laws and regulations that meet the requirements of the Single Audit Act and related OMB Circular A-133. These reports are available in the City's separately issued Single Audit Report.

The accuracy of the City's financial statements and the completeness and fairness of their presentation is the responsibility of City management. The City maintains a system of internal accounting controls designed to provide reasonable assurance that assets are safeguarded against loss or unauthorized use and that financial records can be relied upon to produce financial statements in accordance with generally accepted accounting principles. The concept of reasonable assurance recognizes that the cost of maintaining the system of internal accounting controls should not exceed benefits likely to be derived. Comprehensive written policies support the system and the Office of City Auditor reviews internal accounting controls based upon request or observed need.

This is the third year the City prepared the CAFR using the new financial reporting requirements as prescribed by the GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. This new GASB statement requires that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of a Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The MD&A can be found immediately following the report of the independent auditor.

Profile of the Government

The City of Seattle was incorporated on December 2, 1869. The City operates under a City Charter adopted on March 12, 1946, providing for a nonpartisan Mayor-Council form of government. The City Council is composed of nine members elected at large to four-year terms. The City provides the full range of municipal services authorized by its charter and operates four rate-funded utilities.

The City of Seattle is a primary government for financial reporting purposes. Its governing body is elected by the citizens in a general, popular election. This report includes all organizations and activities for which elected City officials exercise financial accountability. Certain organizations created by or related to the City, for which the City is not financially accountable, have been excluded from this report. Joint ventures, component units, and contingent liabilities, which exist from relationships with organizations created by the City, are included in this report. The notes to the financial statements further discuss the City as a financial reporting entity.

The City provides a full range of services, including the City's infrastructure services. The City builds and repairs roads; maintains electric, water, solid waste, sewer and drainage services; provides police and fire protection as well as judicial services; administers land use policy; and takes an active role in commercial and industrial development and environmental protection. The City designs and maintains many parks and golf courses, coordinates recreation activities, maintains libraries, fosters neighborhood livability, and works to preserve a satisfactory living environment for both the community and individuals.

Budgets and Budgetary Accounting

The City Council approves the City's operating budget. In addition, the City Council annually approves two separate but related financial planning documents: the Capital Improvement Program (CIP) plan and the Community Development Block Grant (CDBG) program allocation.

The operating budget is proposed by the Mayor and adopted by the City Council at least 30 days before the beginning of the fiscal year. The budget is designed to allocate available resources on a biennial basis among the City's public services and programs and provides for associated financing decisions. On a biennial basis, the annual budget is adopted and the following year's budget is endorsed. The budget appropriates fiscal year expenditures and establishes employee positions by department and fund except for project-oriented, multi-year appropriations made for capital projects, grants, or endowments.

The CIP plan is also proposed by the Mayor and adopted by the City Council at least 30 days before the beginning of the fiscal year. The CIP is a six-year plan for capital project expenditures and anticipated financing by fund source. It is revised and extended annually. The City Council adopts the CIP as a planning document but does not appropriate the multi-year expenditures identified in the CIP. These expenditures are legally authorized through the annual operating budget or by specific project ordinances during the year.

The CDBG planning process allocates the annual grant awarded by the federal government. Allocations are made to City departments and non-City organizations. Legal authority is established each year by a separate appropriation ordinance for the Housing and Community Development Revenue Sharing Fund.

The control imposed by the City's adopted budget is maintained through the integration of budgetary accounts in fund ledgers for all budgeted funds. An encumbrance system accounts for purchase orders and other contractual commitments.

Factors Affecting Financial Condition

The Puget Sound region was hit hard by the 2001 recession. Between December 2000 and September 2003 the region lost about 7 percent of its jobs, compared with 3 percent for the State of Washington and 2 percent for the nation. The recession had a major effect on the City of Seattle's revenues, especially certain General Fund tax revenues and revenues derived from tourism and entertainment that are deposited in funds such as the Seattle Center Fund.

The region began to recover from the recession in late 2003. Employment growth accelerated throughout 2004 and approximately half of the job losses due to the recession were recovered by the end of the year. Construction activity began to increase as new commercial, residential, and transportation projects were started. The region's housing market continued to exhibit strong growth, with the proceeds of the City's Real Estate Excise Tax setting an all-time record in 2004. Stronger than expected economic growth provided a boost to several General Fund revenues late in the year, with final sales tax receipts exceeding the November 2004 forecast by 2.1 percent. As a result of this late growth, the City deposited \$3.5 million into the Revenue Stabilization Account, which is intended to provide a cushion for future economic downturns.

Economic outlook

Most economic forecasts predict continued national economic growth through 2008. Employment forecasts for the Puget Sound region have been raised to about 2.5 percent in 2005 and 2.2 percent in 2006. Boeing has started to add jobs as sales of its 737 and new 787 aircraft accelerate. Microsoft continues to expand its facilities and add employees in the region. Several major employers, including Washington Mutual and Safeco, announced plans to expand their facilities in Seattle and to increase employment. Several new office, residential, and biotechnology projects are underway in the South Lake Union neighborhood.

This economic growth is reflected in forecasts of the City's revenues. Sales tax receipts are projected to grow by 4.9 percent in 2005 and 4.0 percent in 2006. The Business and Occupation (B&O) tax, which has a broader base than the sales tax, is forecast to grow by 5.1 percent in 2005 and 4.8 percent in 2006. Some utility revenues, notably electricity sales, are also expected to grow as economic activity generates more demand.

The two biggest threats to the regional economy are a national economic slowdown or a rapid increase in inflation. There is some concern that high oil prices and the budget and trade deficits could hurt the national economy and thus reduce demand for goods and services produced in the Puget Sound area. There are some signs that inflation is picking up both nationally and regionally, with the Seattle Consumer Price Index moving from the one-percent annual growth range in early 2004 to the two-percent range by late 2004. High inflation poses a problem for Washington governments because increases in property tax revenue are capped at one percent annually, plus the value of new construction, under the terms of Initiative 747.

MAJOR INITIATIVES

2005-2006 Budget: The 2005-2006 biennial budget was adopted in November 2004. Initial estimates suggested that projected 2005 General Fund expenses would exceed available revenues by about \$25 million due to a combination of slow revenue growth, operating costs for new voter-approved facilities, and the use of some one-time funds to balance the 2004 budget. The Mayor's Proposed Budget included some fee changes but no tax increases and was balanced by eliminating several lower-priority programs such as the City print shop. The City Council accepted most of the Mayor's proposals but increased certain utility taxes by 1.5 percent to restore some cuts in transportation, library, and other functions. The

Adopted 2005 General Fund Budget totals \$687.5 million and the Endorsed 2006 Budget is \$699.8 million. No cuts were made in uniformed police and fire staffing or library and community center hours.

Several non-General Fund budget issues also received considerable attention. The Water Utility in Seattle Public Utilities had no rate increase as a result of continued efficiencies found through its asset management program. The Fleets and Facilities Department established a new asset preservation program to create major maintenance reserves for City office buildings and shops. The deficit in the Seattle Center Fund was addressed by agreeing to sell certain surplus parking lots for private development. The overall 2005 Adopted Budget totals \$2.827 billion and the 2006 Endorsed Budget is \$2.836 billion.

Streetlights: In November 2003 the State Supreme Court ruled that the City's practice of having Seattle City Light pay for streetlights through utility rates was unconstitutional. This required the City's General Fund to assume about \$6.0 million of annual expenses for streetlights. This change in funding source was made the day after the Court's ruling. The Supreme Court remanded the case to the Superior Court for consideration of other issues and to determine whether refunds of prior streetlight payments would be needed.

In September 2004 the Superior Court issued its rulings on these issues. The Court found that the City used appropriate cost allocation methods to charge the Light Fund in virtually all cases but ordered that the General Fund could not charge the Light Fund for the costs of the Mayor's Office and a small business assistance program. The Court ordered refunds of four years of these payments. The City made these refunds in 2004 and discontinued the practice for future years. The City made a similar change for charges to other utility funds.

The Court also ruled that the City's 1% for Art program could not be applied to City Light. The Utility would be allowed to make art purchases in certain cases but could not participate in the general 1% program. The City has appealed this ruling and a decision is expected in 2005. While the appeal is pending, the City has suspended application of the 1% for Art program for the utilities.

Finally, the Court ordered refunds of the amounts paid by the Light Fund for streetlights prior to November 2003. The General Fund is to repay the Light Fund for these costs and the Light Fund is to issue rebates to customers. Approximately one-fourth of the General Fund repayment was made in 2004 and the remaining amount is split among 2005, 2006, and 2007. Since City Light must issue rebates in 2005, the last two years of the General Fund's repayments were financed with short-term debt issued early in 2005, which will be repaid in 2006 and 2007.

Fire Facilities and Emergency Response Program: In November 2003 the City's voters approved a nine-year \$167.0 million property tax levy lid lift to replace or remodel almost all of the City's fire stations, build a new Emergency Operations Center (EOC) and Fire Alarm Center (FAC), develop a Joint Training Facility, replace or refurbish the City's fire boats, and purchase or build a variety of emergency response equipment and facilities. The ballot measure passed with a 67 percent "yes" vote. Construction of the Training Facility began in 2004 and land for the combined main fire station, EOC, and FAC was acquired in the fall. Fireboat designs are underway with bidding expected in 2005.

Families and Education Levy Renewal: Seattle's voters approved an extension of the Families and Education levy lid lift in September 2004 with a 62 percent "yes" vote. This \$116.8 million seven-year levy will continue to provide funding to support children's and family services, with a new focus on improving academic achievement. Each component of the levy will have clear accountability measures so that funds can be directed to the most successful programs.

Civic Center: Seattle's new Civic Center was almost complete at the end of 2004. The plaza on the west side of the new City Hall will be finished in early 2005, which will complete construction of the new facilities started in the late 1990s. The Park 90/5 complex, which houses a variety of "back office" City functions, opened in mid-2004. The City is in the process of soliciting proposals to sell the Arctic and Alaska buildings, with their tenants expected to move into the Seattle Municipal Tower in 2006. The one remaining issue is the disposition or reuse of the block that formerly housed the Public Safety Building. The Building will be demolished in 2005 and it is likely that the site will be redeveloped with a combination of a public plaza and commercial office space and/or housing.

Other City Capital Projects: The Seattle Public Library continued to develop a variety of projects funded from the Libraries for All bonds. Most notably, the new Central Library opened in May 2004 and received resounding praise for its architecture and the accessibility of the collection. Several new or refurbished branch libraries also were completed in 2004. The Parks Department continues to develop new or expanded community centers and other facilities using funds from two voter-approved levy lid lifts. These funding sources also have paid for the purchase of additional open space throughout the City. Seattle Public Utilities completed the Cedar River treatment plant, which now means that both major sources of water for the City's system receive advanced water quality treatment.

Bond Issues: The City continued to take advantage of low-interest rates to finance new projects and to refund older bonds to capture interest rate savings. In April the City refunded \$91.8 of its 1996A Limited Tax General Obligation bonds at a true interest cost of 4.103 percent. The present value savings totaled \$5.1 million, or 5.81 percent. All of the City's General Obligation bond ratings were reaffirmed. No new general obligation bonds were issued in 2004.

The Water Utility sold \$84.8 million of new money bonds in October at a true interest cost of 4.579 percent. The Utility's ratings were reaffirmed.

The Drainage and Wastewater Utility sold \$62.0 million of new money bonds in October. The true interest cost was 4.586 percent and the Utility's ratings were reaffirmed.

Seattle City Light sold \$284.9 million of new money and refunding bonds in December 2004 at a true interest cost of 4.175 percent. The refunding portion of the sale generated present value savings of \$14.7 million, or 6.83 percent. Both Moody's and Standard and Poor's upgraded their outlook on City Light bonds.

Urban Area Security Initiative: The City of Seattle received a significant amount of federal funding under the Urban Area Security Initiative (UASI). Two different allocations, one directly to the City and one shared with other governments in the region, provided approximately \$30.0 million for Seattle in 2003/2004. Most of these funds will be devoted to equipment and training for the Police and Fire departments. Additional funds will be used to improve the security of the City's technology and to support emergency preparedness for the utilities.

Cash Management

The Treasury Services Unit of the Department of Executive Administration, administers all cash-related transactions for the City of Seattle. City cash (exclusive of pension fund cash administered by the Seattle City Employees' Retirement System and some debt refinancing proceeds administered by trustees) is deposited into a single concentration banking account.

Investments of temporarily idle cash are made according to City Council-mandated policies in U.S. Treasury and agency issues, certificates of deposit and other investment deposits issued by Washington

State depositories that qualify under the Washington State Deposit Protection Act as defined by RCW 39.58, bankers' acceptances sold on the secondary market, commercial paper purchased in the secondary market, repurchase and reverse repurchase transactions, the public funds investment account known as the Local Government Investment Pool (LGIP) in the State Treasury, and other securities as authorized by law. The City is allowed to engage in securities lending transactions, the fees for which are credited to the investment income account. City policies require the City to minimize market risks by safekeeping all purchased securities according to governmental standards for public institutions, to maintain liquidity by restricting the City's total investment portfolio to an average life of no more than five years, and to consider social goals in the placement of investments. A report on the performance of the investment program in meeting these policies is prepared monthly for review by the Director of Finance and the Director of Executive Administration and forwarded to the City Council's Finance and Budget Committee.

The market value of investments held in the pooled and dedicated funds' combined portfolio under the direct supervision of the Treasury Services Unit as of December 31, 2004, was \$782.6 million with earnings of \$14.7 million and a return on investment of 2.338 percent.

Risk Management

In 2004 the City purchased an excess liability insurance policy to address general, automobile, professional, public official, and other exposures. The policy has limits of \$25 million above a \$5 million self-insured retention for each occurrence. The City also purchased an all-risk property insurance policy that provides \$500 million in limits above a \$500,000 deductible (for most buildings) with \$100 million in earthquake and flood limits and \$100 million in terrorism limits, with boiler and machinery, building risk, and electronic data processing coverage endorsements. Hydroelectric and other utility producing/processing projects owned by the City are not covered by the property policy.

Insurance is also in place for excess workers compensation, fiduciary and crime liability, contractor's equipment, transportation, inland marine, fine arts, volunteers, and an assortment of commercial general liability, medical, accidental, death and dismemberment, and miscellaneous policies. Bonds are purchased for public officials, notary public, pension exposures, and specific projects and activities as necessary.

Pension Trust Fund Operations

The operation of the Seattle City Employees' Retirement System resulted in a net total investment return of \$172.0 million (11.5 percent). This compares to a 23.6 percent return in 2003 when the rebounding financial markets in the U.S. and abroad resulted in a net gain in value of \$291.0 million. The total net assets held at the end of 2004 were \$1.684 billion, an increase of \$157 million from 2003. The actuarial accrued liability at January 1, 2004, was \$1.779 billion with a \$251.4 million unfunded actuarial accrued liability.

Additional information on the City of Seattle's Pension Plans can be found in Note 10 in the notes to the financial statements.

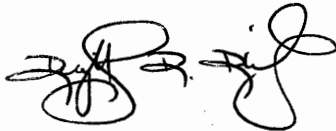
Certificate of Achievement

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Seattle for its comprehensive annual financial report for the fiscal year ended December 31, 2003. The Certificate of

Achievement is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government financial reports.

I would like to express my appreciation to the entire staff of Accounting Services, other members of the Department of Executive Administration, and other City departments who contributed to the preparation of this report. Finally, I thank you for your interest and continuing support in planning and conducting the City's financial operations in a responsible manner.

Sincerely,

A handwritten signature in black ink, appearing to read "D. Dively", with a stylized flourish at the end.

Dwight D. Dively, Director
Department of Finance

Certificate of Achievement for Excellence in Financial Reporting

Presented to

City of Seattle,
Washington

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
December 31, 2003

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Seattle for its comprehensive annual financial report (CAFR) for the fiscal year ended December 31, 2003. This was the twenty-fourth consecutive year that the government has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.



President

Executive Director

City of Seattle

DEPARTMENT OF EXECUTIVE ADMINISTRATION

